

REPUBLIC OF ICELAND
NOVEMBER 2009

IES/02: ATTACHMENT N

CREDIT GUARANTEE COUNTRY PROFILE:

Country Rating	<u>S/T Business Cycle Indicator</u>	<u>S/T Political Indicator</u>
ZZ	↓/→	→

Credit Guarantee Experience

We do not have any claims experience in this country where we are currently off cover.

Political Highlights

- ❑ Social Democrat Johanna Sigurdardottir took over as Prime Minister, after Geir Haarde, of the centre-right Independence Party, resigned in January amid mass street protests following the country's economic collapse. Sigurdardottir is Iceland's first female PM and she took office as the head of a coalition of her centre left Alliance party and the Left-Green movement. The new government was set to be in power until elections on 25 April.
- ❑ Iceland's interim centre-left government has won a resounding victory in the April 25 parliamentary elections. The Social Democrats under the leadership of Johanna Sigurdardottir won with 29.8% of the votes. The conservatives' Independence Party got 23.7% of the vote securing 16 seats, conceded defeat after its worst elections results in decades. For the first time in the history of the Icelandic Republic, left parties gained majority. The Left Green Movement got 21.3% of the vote and a new party led by protesters got 7.2%. The left-green formed a minority government with the social democrats and both parties planned to continue their coalition if they got enough votes but it doesn't necessarily mean they will form a new government.

Recent Economic Highlights

- ❑ Iceland has a population of 307,000 people with an expected population growth rate of 0.7% in 2009.
- ❑ A year after the banking crisis brought Iceland to the brink of bankruptcy, the country is mired in the deepest recession among advanced economies. The stock market has lost 97% of its value with over 780 companies collapsing under the strain of foreign currency loans as the krona plunged. The prime minister pins his hopes for a recovery on the IMF after the three banks, Kaupthing hf, Landsbanki Islands hf and Glitnir Banki hf racked up \$80bn in debt – 16 times Iceland's economic production. Now there is a greater fear that the country may implode, as a dispute over Icelandic savings accounts held by overseas depositors, delays a promised \$5.1bn bailout.
- ❑ GDP growth is estimated at 0.3% in 2008 and the IMF predicts the economy will shrink 10.5% this year with household consumption plunging 25% and a 34% drop in fixed investments. Government forecasts the economy to shrink 8.5% this year and consumer prices will climb 11.7%, both the worst performances among the world's 33 advanced economies according to the IMF's latest forecast. Iceland's recession will stretch into next year, with the economy contracting 2% in 2010. Unemployment will rise 8.6% this year from less than 1% in December 2007.
- ❑ One of the hardest hit industries has been the construction industry where 202 companies filed for bankruptcy in the 11 months after the crash – 67% more than the same period of the previous year.
- ❑ IMF funding hinges on efforts to settle the claims of overseas depositors who had accounts with Icesave, a unit of Landsbanki Islands. The UK and Dutch Governments have stalled funding until Iceland agrees to cover the claims. Government estimated that Iceland will post a deficit of 182.3bn krona (\$1.5bn) or 14% of GDP this year. Parliament may demand that Government abandon its IMF economic programme and forgo further loan payments after the IMF delayed the review of the programme for eight months. Iceland qualified for a \$4.6bn bailout from the IMF.
- ❑ Iceland's finance minister signed a deal with Poland to receive the equivalent of \$200m in long-term financing as part of its ongoing drive to prop up its struggling economy and shaky currency. The loan of 630m Polish zloty will be used to purchase Polish treasury bonds, which can be sold by Iceland's central bank in the public to raise funds if needed.
- ❑ Iceland is hopeful that it can finance its budget deficit internally and will draw on reserves both from the central bank and pension funds to do so. Iceland's budget deficit will be 150bn-160bn krona (\$1.31bn) this year. The government has reserves of the same amount at the central bank and can draw on those as well as the national pension funds that have considerable investment capacity. Should the government struggle to cover its deficit internally, it may once again call on its neighbours for help. Iceland will have a gross debt of between 80%-100% of GDP by the end of this year.
- ❑ Iceland wants to encourage foreign ownership of its banks and may enable creditors of failed lenders to become shareholders as a means of achieving a stable financial system. Foreign creditors have waited since October last year to find out how they can recoup as much as 10.5 trillion krona (\$89bn) in debt. The state took over the banks without making itself liable for their foreign obligations. Iceland is relying on a \$10.1bn IMF-led loan to rebuild its economy after the banking collapse brought down the krona. Largely untapped natural resources are likely to provide the key to its recovery from the economic crisis, though concerns have been raised over their potential environmental impact.
- ❑ Iceland is developing a plan to ask domestic owners of foreign assets to exchange their holdings for the country's bonds owned by overseas investors as the government seeks to rebuild confidence in the economy. International investors own as much as

400bn krona (\$3.6bn) in local currency denominated bonds, which the central bank is concerned may be dumped once capital controls imposed during the banking crisis are removed, thereby destabilising the krona. The government may also encourage foreign investors to exchange their Icelandic bond holdings for securities with longer maturities to stem the outflow of capital. The proposed plan is significant because it gives international investors an exit, having had their investments frozen since trading in the krona was stopped last year.

- ❑ With Iceland's economic meltdown sending its currency into freefall, tourists who saw this remote North Atlantic Island as prohibitively expensive are now flocking to its volcanic scenery. Last year 502,000 tourists visited the nation of just 307,000. In 2006, tourism accounted for 4.1% of GDP and currently employs an estimated 8200 people. A record 353,110 people visited the country in the first eight months of this year, selling out hotels and filling restaurants.
- ❑ The fishing industry has been the other survivor in this economy. HB Grandi hf, Iceland's largest fishing company hauls 12% of the country's total catch, including cod, halibut and haddock and exports all of its fish. The company has not laid off any of its 650 staff and employees received a salary increase this year.

Trade Developments

- ❑ Main exports: fish and fish products, aluminium, animal products, ferrosilicon and diatomite.
- ❑ Main imports: machinery and equipment, petroleum products, food and textiles.
- ❑ Major trade partners: Netherlands, Germany, UK, Ireland, US, Spain, Japan, Sweden, Denmark, China and Norway.
- ❑ Russia and Iceland have failed to reach an agreement on a loan to boost Iceland's crisis-hit economy but are continuing with negotiations. Russia is considering a \$500m loan to Iceland.
- ❑ South African exports to Iceland totaled R101.5m in 2008 and R307m in 2007 and R7m in the year-to-July 2009.

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